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SUBJECT: ARGENTINA: PAMPA HOLDINGS BETS ON GOVERNMENT PROMISE TO
REWARD NEW ELECTRICITY GENERATION CAPACITY

Ref: (A) Buenos Aires 1726
(B) Buenos Aires 1456
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internet distribution.

Summary

1. (SBU) Pampa Holdings, one of Argentina's largest investment funds with a market capitalization of over \$760 million, is aggressively expanding its participation in Argentina's electricity generation, transmission, and distribution sectors. Pampa principal Carlos Mindlin described his investment strategy to Ambassador as (1) buying quality "distressed" energy assets cheaply as large multinationals re-position themselves out of the Argentine market (e.g. CMS, Total, Electricite de France); and (2) investing to build incremental electricity generation capacity based on the GoA's promise to reward new capacity with closer to international market returns. If the GoA continues to keep domestic retail and wholesale energy prices significantly below international market levels, Argentina will require roughly 1,000 MW of new generating capacity in each of the next 4-5 years simply to keep up with growing domestic demand. The GoA has announced over US\$ 10 billion in new energy infrastructure projects in the past few months (Ref A), but a recent study argues that Argentina will need US\$ 3 - 4.5 billion worth of new energy investment each year to meet demand. Mindlin argues that, sooner or later, the GoA will have to compare the relative costs and ability to deliver of public vs. private sector players. Pampa appears to be benefiting from the Kirchner administration's unofficial policy favoring domestic ownership of

energy assets. End Summary.

Pampa Holdings: Energy Investment Vehicle

¶2. (SBU) Ambassador and EconCouns met August 28 with Marcelo Mindlin, Chairman of one of Argentina's largest investment fund Pampa Holdings (and senior manager of Pampa's majority owner, the Dolphin Group) to review Pampa's growing investment in Argentina's electricity generation and distribution sector. Originally a refrigeration storage company, Pampa was acquired by the Dolphin Group in 2005 to serve as its investment vehicle for "distressed valuation" energy assets. According to Mindlin, 50% of Pampa Holding equity is held by Argentine nationals, 35% by U.S. interests (including U.S. investment fund Eton Park with a 4-5% stake, Ref D) and the remainder primarily by European interests.

¶3. (SBU) Mindlin called Pampa's first two years of growth "spectacular" and emphasized that Pampa's strategy is to continue growing via equity rather than debt funding. Pampa was taken public in 2006 and, with a market capitalization of over US\$ 760 million, it is now the second-most heavily weighted stock on Argentina's benchmark MerVal index. In addition, Pampa took its Edenor electricity distribution subsidiary public in 2007 with an equity issue of over \$300 million. In a comment on the relative under-development of Argentina's capital markets and the lack of home-grown entrepreneurial spirit, Mindlin noted that in all of 2006 and 2007 there have been only four major Argentine equity issues (Pampa, Edenor, Banco Macro and Banco Patagonia) for roughly US\$ 2 billion. This amount, he said, is equivalent to a week's worth of equity issues in Brazil's deeper and far more active markets.

¶4. (SBU) Key Pampa Group holdings includes its ownership of Buenos Aires power distribution company Edenor (with roughly 2.4 million retail clients), its stake in national electricity distribution network Transener (Ref D), and its equity stakes in a portfolio of electricity generation assets. These include two hydroelectricity generation complexes in Mendoza province (Nihuiles and Diamante, which provide 2.7% of national capacity), Central Termica Guemes in Salta province, Loma de la Lata in Neuquen province, and Central Puerto in Buenos Aires province.

Pampa Strategy: Buy Low, Build Capacity

¶5. (SBU) Mindlin described his investment strategy as (1) buying quality "distressed" energy assets cheaply as large multinationals re-position themselves out of the Argentine market (e.g. Total, Electricite de France, CMS); and (2) investing to build incremental capacity of these generation assets under the GoA's "Energy Plus" scheme, whereby new private sector capacity is to be purchased by the GoA-regulated wholesaler CAMESSA at rates higher than those paid for existing capacity. Mindlin noted that Argentina will require roughly 1,000 MW of new generating capacity in each of the next 4-5 years simply to keep up with growing domestic demand. (Separately, a recent study prepared by the prestigious Technical Institute of Buenos Aires, ITBA, concluded that Argentina will need US\$ 3 - 4.5 billion worth of new energy investment each year to meet demand. Pampa has already contracted to build 100 MW of incremental capacity at its Central Termica Guemes facility in Salta province.

¶6. (SBU) In response to the Ambassador's question on the GoA's announcement of over US\$ 10 billion (Ref A) in new energy infrastructure projects in the past few months, Mindlin argued that, sooner or later, the GoA will have to compare both the relative costs of public vs. private sector and the relative ability of public vs. private sector players to deliver projects on time. Public sector costs are high due to general government inefficiency and pervasive corruption, he said. As a result, Pampa has declined to get involved in some energy sector projects where high levels of government procurement are involved, including the expansion of natural gas pipeline capacity (Ref E). Public sector energy construction has been plagued by delays, Mindlin said, noting a 2-year delay in the GoA's construction of the two 800 MW "Foninvenmem" generators (Ref B) as an example.

The Transener Electricity Transmission Company Deal

¶7. (SBU) Pampa holds a minority stake but management control of regulated national electricity transmission company Transener. Mindlin commented on the GoA's decision earlier in 2007 to reject the bid of U.S. investment fund Eton Park to buy out Brazilian state oil company Petrobras's minority equity stake in Transener (Ref D) in favor of a joint venture of local construction company Electroingenieria and GoA state-owned energy company ENARSA. Electroingenieria, he said, had experience in building transmission lines, but no experience running a transmission company. If the GoA does not significantly raise regulated transmission rates in the next three years, Electroingenieria will have difficulty servicing the debt it has incurred to purchase its share of Transener.

Bio Note on Marcelo Mindlin

¶8. (U) Marcelo Mindlin is the Chairman of Pampa Holdings S.A. and, since 1989, has served as Senior Portfolio Manager of Grupo Dolphin S.A. Previously, from 1991 to 2003, Mindlin was Vice Chairman and CFO of IRSA (Inversiones y Representaciones S.A.), a major Argentine real estate development group controlled by prominent local entrepreneur Eduardo Elzstain with substantial Soros Group investment. From 1999 to 2004, he served as a Board Member at the formerly state-owned Banco Hipotecario (now controlled by IRSA). From 1996 to 1999, he was a Director of Fondo de Valores Inmobiliarios in Venezuela and of Brazil Realty in Brazil.

¶9. (U) In November 2003, Mindlin left the IRSA Group, and, with 15-odd years of portfolio management and corporate finance experience, founded the Grupo Dolphin S.A. Mindlin holds a Masters in Business Administration from Universidad del CEMA (Center of Macroeconomic Studies) and a degree in Economics from Universidad de Buenos Aires.

Comment

¶10. (SBU) Pampa Holdings, with its aggressive investment profile and attractive returns on capital to date, is one of the darlings of the Argentine market. It is widely rumored in local financial circles that President Kirchner has invested a portion of his own wealth in Dolphin/Pampa equity. While most local energy analysts agree that Pampa has indeed purchased quality energy assets cheaply, they have different interpretations of why the purchase prices have been so low. Some argue that the Kirchner administration, besieged by ICSID international arbitration suits filed by multinational energy companies in the aftermath of the 2001/2 economic crisis that seek cumulative awards worth billions of dollars (Ref F), made a strategic decision to decrease international participation in Argentina's energy sector and to increase both direct state and private Argentine participation. To "encourage" foreign multinationals to cede control of electricity assets, the GoA is said to have used its formidable power to delay needed post-devaluation rate adjustments. As a case in point, they note Pampa/Dolphin's 2005 purchase of a 65% stake in Argentina's largest electricity distributor, Edenor, for \$100 million while Electricite de France (EDF) had paid US \$800 million for a smaller 45% stake in ¶2001. EDF had filed an ICSID suit against the GoA following the economic crisis and had been unable to negotiate a tariff rate increase to return to profitability. Shortly after its purchase by Pampa, Edenor negotiated a 28% interim tariff increase for rate payers.

¶11. (SBU) Pampa's own strategy of building incremental generation capacity based on the GoA's promise to reward new capacity with returns closer-to-international-market levels appears a high-risk play given the precarious finances of regulated electricity wholesaler CAMESSA. The GoA's CAMESSA is a full six months behind on capacity and variable cost payments to generators, and is also footing the bill for the GoA's expensive "Total Energy" diesel fuel subsidy program (Ref B). Pampa is betting that the GoA will -- sooner than later -- adjust internal energy market prices to

encourage and reward new investment. Others are not so sanguine, and wonder how quickly and aggressively the next GoA administration will move to rationalize energy prices.

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